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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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UNITED STATES OF AMERICA

v.

08CR181(TPG)

MARIO LEVIS,
Defendant.

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New York, NY
February 2, 2010
2:50 p.m.

Before:

HON. THOMAS P. GRIESA

District Judge

APPEARANCES

PREET BHARARA
United States Attorney for the
Southern District of New York
DANIEL BRAUN
WILLIAM STELLMACH
Assistant United States Attorneys
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(Case called)

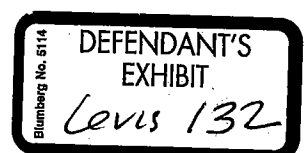
THE COURT: Good afternoon. Thank you for coming up from Florida. Let's start by letting the government say what its case is.

MR. BRAUN: Thank you, your Honor. We appreciate the opportunity to do so. We covered some of this ground in our phone conference last week and we will pick up essentially where we left off.

THE COURT: You'd better start, don't assume that I retained, don't give me a test on it.

MR. BRAUN: I will not, judge. I note from what you said during the phone conference that you had not read the letter we submitted but we set this forth in the letter as well

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14 but I won't assume that either.

15 THE COURT: You tell what the case is.

16 MR. BRAUN: Sure, your Honor. I think it would be
17 helpful if we use the charts here that we have and defense has
18 copy of this as well. I am going to turn these around on the
19 easel. I will hand up a smaller set.

20 THE COURT: If the defense lawyers or anybody wants to
21 move around, please do so.

22 MR. BRAUN: Your Honor, this is a securities fraud
23 case and the case relates to a particular asset that was held
24 by the financial institution in Puerto Rico that the defendant
25 worked at as an officer, as an executive officer of Doral

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1 Financial. Doral Financial held on its books an asset called
2 an interest-only strip, and that's what is depicted on this
3 chart.

4 what Doral did, they were in the business of making
5 loans; they were the leading mortgage lender in Puerto Rico.
6 After making loans to borrowers, they would pool these loans in
7 large groups, your Honor. These groups were \$50 million, \$100
8 million on up to \$1 billion in a pool. They would sell these
9 pools of loans to other financial institutions in Puerto Rico.

10 Under the terms of Doral's contracts with these other
11 financial institutions, which include the two at issue here,
12 First Bank and R&G, but there were others as well. The banks
13 that bought these pools of loans were entitled to receive from
14 Doral, Doral would continue to service the loans, your Honor,
15 they would continue to interact with the borrowers, so they
16 would receive the payments on the loans from borrowers.

17 Doral would then pass along to the purchasers of these
18 loans, the other banks in Puerto Rico, all of the principal
19 that was owed on the loan, as well as a portion of the
20 interest. That portion of the interest, your Honor, depicted
21 in the lighter green color on the first chart was called the
22 pass-through rate.

23 what Doral kept under the terms of these contracts,
24 your Honor, was the remaining portion of the interest and a
25 servicing fee of a quarter percent. So they would get .25

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1 percent as a fee for continuing to service the loans and then
2 of the interest payments that came in, they would split those
3 with the purchasers of the loan pools.

4 THE COURT: They would split what.

5 MR. BRAUN: The interest, the interest part of the
6 payments made on these large pools of loans. If you are a
7 borrower and you borrow 50 or \$100,000 from Doral, all of your
8 principal payments on that loan go to the bank that has bought
9 the pool of loans from Doral.

10 The defendant personally negotiated these deals with
11 the other banks and he signed all of the contracts with the
12 other banks that set forth the terms of these deals, so he is
13 quite familiar with the terms of Doral's contracts and
14 transactions with these other banks that would buy the loans.

15 Let me repeat what the nature of these transactions
16 was. If you are a borrower, you borrow \$100,000, that \$100,000
17 as it gets paid back, the principal portion, would go to the
18 purchaser of the loan pool, the other bank, not Doral. That

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19 other bank, your Honor, would also get a piece of the interest
 20 that the borrower paid back. That was called the pass-through
 21 rate. Doral would retain its right to the remainder of the
 22 interest payments that were made on those outstanding loans.
 23 They would then determine how much that interest was
 24 worth, over the projected term of the outstanding loans in the
 25 pool and they would record that amount on their books as a

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1 profit, as a gain on the sale of the pool of loans that Doral
 2 had originated and then sold to the counterparty banks, the
 3 banks like First Bank, R&G, Western Bank down in Puerto Rico.
 4 There were others as well who would buy these large pools of
 5 loans from Doral Financial.

6 This was a very important asset for Doral. It became
 7 a very significant part of Doral's balance sheet. It became a
 8 very significant part of Doral's profitability and of its
 9 reported revenue streams.

10 THE COURT: The numbers on the left-hand side, what
 11 are they.

12 MR. BRAUN: These are just hypothetical numbers to
 13 show the way in which these various interests might be divided
 14 up. So, in a hypothetical loan where the interest is up here
 15 at the top, judge, the .25 in red would be the servicing fee
 16 that Doral gets to keep between 3.5 and 9. This 5.5 percent
 17 would be Doral's retained spread, the portion of the interest
 18 that Doral would get to keep.

19 The other numbers are just again hypothetical examples
 20 to show you how these interests are broken down under the terms
 21 of the deals that the defendant negotiated and signed; they are
 22 not drawn from an actual example.

23 THE COURT: 3.5 percent of what.

24 MR. BRAUN: Of the interest, of the interest that the
 25 borrower would owe. So if the borrower owed 7 or 8 percent

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1 interest on the loan, 3.5 of that in this example would be
 2 passed through to the banks that purchased the loan, a
 3 remaining 5.5 percent would be kept by Doral, retained by
 4 Doral, and .25, the remaining .25 would be the servicing fee.
 5 This is an example, your Honor, of an interest-only
 6 strip. This piece, the yellow, it was called an interest-only
 7 strip. That's the asset that this case revolves around. In
 8 this particular example as it indicates at the top of the
 9 chart, this would be a fixed rate interest-only strip, because
 10 the pass-through rate, as I am about to explain, was fixed in
 11 this example at 3.5 percent.

12 Doral would typically enter into these deals, your
 13 Honor, earlier on in time and that practice changed as we got
 14 further away from 2000, closer in time. So 2000, 2001, 2002,
 15 Doral started to change the terms of these transactions with
 16 the other banks in Puerto Rico in a way that's very meaningful
 17 to our case.

18 So moving on from the fixed-rate IOS, where this 3.5
 19 percent as an example is fixed, that's the amount of the
 20 interest that the other bank is going to get going forward,
 21 Doral started to enter into more and more of these loan sale
 22 transactions that provided for a floating pass-through rate.

23 The share of the interest payments that the other bank

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24 was entitled to under these deals, your Honor, was not fixed at
 25 3.5 percent or at any percent for that matter. Doral started
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1 entering into more and more transactions in which the banks
 2 that purchased these large pools of loans were entitled to a
 3 pass-through rate, a share of the interest that would be paid
 4 on these loans that would vary with an interest rate called the
 5 London interbank offered rate. It's an interest rate that you
 6 and I can't get when we go to the bank to seek a loan; it's an
 7 interest rate that banks can get from other financial
 8 institutions or government-lending institutions.

9 So LIBOR, as the London interbank offered rate is
 10 called, is set out there. It typically goes up and down with
 11 the Fed rate and under the terms of these floating rate IO
 12 transactions, Doral agreed that it would pass through to the
 13 purchasers of the loan pools, a share of the interest that
 14 varied with LIBOR. It would typically be, your Honor, it
 15 varied contract to contract how much these other banks would
 16 get, but it was usually in the neighborhood of LIBOR plus
 17 roughly one-and-a-half percent. You see some deals at 1.2
 18 percent, some at 1.4, some perhaps as high as 1.6, but all in
 19 that range, you get the idea.

20 THE COURT: The smaller, those are passing through to
 21 the banks less than the 3.5.

22 MR. BRAUN: Sorry to interrupt. It would entirely
 23 depend on LIBOR.

24 THE COURT: Maybe it's not relevant, but was it
 25 generally smaller than had been before or is that not relevant.

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1 MR. BRAUN: In some of the deals there was a floor on
 2 the pass-through rate that said the banks that purchased the
 3 loan pools would always get X amount, perhaps 3.5 percent,
 4 whatever it happened to be. In most of the contracts, this
 5 pass-through rate could vary as interest rates went up and
 6 down. These are just examples that are made up to illustrate
 7 the nature of this instrument, of this asset. So if it's LIBOR
 8 plus a point and a half, which is what the other banks get is
 9 3.5, here is Doral's spread like it was in the last chart, 5.5.

10 Let's say interest rates go up, as happened in 2003
 11 and 2004. Interest rates were very low, your Honor, in 2001,
 12 particularly after September 11, 2001, and the way the economy
 13 was struggling here and elsewhere, interest rates were kept low
 14 for a period of time. Then they started to creep up and they
 15 continued rising during the relevant time period in this case.

16 As interest rates come up, the pass-through rate, the
 17 part of the interest payments that the other banks are going to
 18 receive, also increases, and as LIBOR drops, if it does drop,
 19 the pass-through rate decreases. Doral's spread, your Honor,
 20 therefore has an inverse relationship with interest rates. As
 21 interest rates rise, the portion of the interest payments they
 22 have to give to the other banks also rises, and Doral's spread,
 23 what they are allowed to retain, diminishes, it compresses; as
 24 interest rates drop, Doral's spread increases, the pass-through
 25 rate compresses, gets smaller.

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So that's why as you will hear, your Honor, sometimes these instruments, they are not very common, but when they do exist they are called inverse floating IOSSs, because the value of them varies inversely with interest rates. And they can go up and down with interest rates under the terms of the transactions that Doral entered into with these other Puerto Rican banks which were buying the pools of loans.

With that background in place, your Honor, here is our case. It is our case that the defendant deceived people in the investing public to provide them with false assurances regarding these interest-only strips that Doral had on its books and that again were very important to the financial condition and profitability of Doral during the relevant time period. These false representations regarding the IOS that the defendant made to other banks fall into two categories.

One category of misrepresentations described in the indictment relates to statements the defendant made telling others that the pass-through rate, the share of the interest that other banks were entitled to under the terms of these floating rate contracts, was capped. That's what this red line on the third chart represents.

Just for context, this is important, this historical context, in early 2005, Doral issued a public statement informing the investing public that it was reducing the value, reducing the reported value of its IOS portfolio, interest-only

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strip portfolio, which was at the time up in the 8 to \$900 million range.

They said we are actually reducing that by \$97 million or thereabouts; it could have been \$97.5 million. That takes place in January 2005 where they publicly state an impairment by close to \$100 million of the value of these IOSSs on Doral's books. Needless to say, there were plenty of questions about the IOSS from investors and market analysts prior to that time. Needless to say, when you tell the world, you know what, they are worth \$100 million less than we said before, it raises additional concerns and questions.

It was particularly in the aftermath of that, your Honor, and in an economic environment in which interest rates were rising and were predicted to continue rising that the defendant assured a number of people --

THE COURT: The first representation to the public was what again.

MR. BRAUN: The statement that they made to the public in January 2005 is our collection of IOSSs, our portfolio of interest-only strips is worth over \$97 million less than we had said; we are going to impair the value, we are going to state an impairment to the value of our interest-only strips.

THE COURT: Does the government claim that was false.

MR. BRAUN: No, but that fact is significant because it's in that context, your Honor. What we do claim is false is

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what the defendant said in response to people who were very worried about the value and the stability of the value of the IOSSs, of the portfolio of IOSSs that Doral held.

In that context, after they said it's worth \$100

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million less, I am approximating, it was 97.5 to be precise, what the defendant says to others, and he says this on email and in personal meetings, is our contracts with these other banks have caps on the pass-through rates. The pass-through rates that the purchasers of those loans pools are entitled to obtain are capped at a certain point. So those caps, we are about to hit them he says to some people, so even if interest rates continue to go up which they had been doing, our spread is protected.

The pass-through rate can only hit the red line, in other words, and he would sometimes quantify it and sometimes he would simply say we are just at about that point, interest rates have risen to the point we are about to hit the cap. Some people he actually told them we are always going to have 2 to 3 percent; in some representations it's 3.3 percent. The numbers change depending on who he is talking to, your Honor. But he says to a number of folks, the pass-through rate is capped.

LIBOR goes up, it doesn't hurt us; you are not going to see another one of these big impairments to the value of our interest-only strip portfolio. We are protected; there is a

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cap. There is a cap in the contracts; all these contracts have caps. So when the pass-through rate hits the red line, that's it. The banks that purchased these loan pools can't do any better; we can't do any worse. That's one category of misrepresentation that our case is based on.

THE COURT: And the government is saying that there was no such cap.

MR. BRAUN: We are saying that to the extent there were caps, and this is important given the argument the other side is making, some contracts had caps, your Honor, some, not all, some, and those caps are all the way up here. They prevent Doral's spread from being reduced past nothing. They allow Doral's spread to be reduced to zero.

THE COURT: Say that again.

MR. BRAUN: The red line here, when you look at the contracts, when you look at the defendant's representations, he is saying it's here, in substance. When you look at the contracts that have caps, they don't all, but when you look at the ones that have the caps, your Honor, those caps are written all the way at the top so that Doral's spread, the yellow here, can be reduced to zero.

But in the event that interest rates rise so high that the pass-through rate, which is LIBOR plus a point and a half, let's say the borrower, your Honor, is borrowing at 8 percent from Doral so that 8 percent is all there is, and let's say

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LIBOR gets to 7 percent so that the pass-through rate is 7 plus 1-1/2, 8-1/2, right, that's .5 percent higher than the interest that the borrower is paying.

So what these caps do, your Honor, is they say Doral's spread can't get any less than zero, it can go to zero, but once LIBOR plus a point and a half gets higher, then the entire interest payment that's being paid by the borrower, once it gets higher than that 8 percent that the borrower is paying on his mortgage loan, it can't get any higher than that.

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So even if a bank that purchases a pool of loans from Doral might otherwise be entitled to 8-1/2 percent, because that's LIBOR plus a point and a half, if there is only 8 percent coming in in total in interest on this loan, that's it. That's the most that Doral is going to pass through to the purchaser of the loan pool. That's a very different kind of cap, your Honor, than the kind of cap the defendant was describing.

THE COURT: That's the most that Doral is going to pass through. I don't understand the significance of that; I just don't get that.

MR. BRAUN: Absolutely. I am going to mark up this chart a little bit. In a floating rate IOS, the pass-through rate, which is the light green portion of the chart, the dark green is principal, that's all going to the purchasers of the loan pool, the terms of these deals say we are going to split

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the interest. Doral is going to keep some; the buyer of the loan pool is going to get some. The buyer gets the green, the lighter green here; Doral gets the yellow.

The defendant is telling folks that there are caps in the contracts such that they are going to protect Doral's spread, the yellow, the part Doral gets to keep from getting smaller. And that would result in another downgrade of the value of this asset like they already suffered, right. So he is saying to everybody, we are not going to get hurt again like that, it's not going to keep happening, it's not going to get even worse than it is.

The caps that we see in the contracts, some of them, have caps on the pass-through rate that say the pass-through rate can't get any higher than all the way at the top. So all of this yellow can go away; that's gone. Doral's interest-only strip in that scenario once LIBOR plus a point and a half gets higher, once interest rates plus a point and a half get all the way up to here to 9 in this example, then the pass-through rate paid to the purchasers of the loan pools is equal to all the interest being paid on these loans.

All of the interest goes to the buyer of the pool. Doral gets zero. Right. Its yellow piece on this graph is gone. The caps that are in these contracts, some of them, say that's as bad as it gets for Doral and as good as it gets for the other party. In this example, it's at 9 percent. So, if

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LIBOR is at 7.5, and LIBOR plus a point and a half is 9, then, that's it; everything gets passed through to the buyer, Doral gets zero, and the cap says no more. Without that cap --

THE COURT: I don't quite understand the significance of such a cap. In other words, if there was not such a cap then would Doral owe even more interest than the borrower.

MR. BRAUN: That was what the cap addressed. Let's say you are already up here at the top and interest rates keep climbing, let's say they go to 8, so that if there were not that cap in these kinds of contracts, the borrower would be paying 8 percent, the person who takes out the mortgage loan, but the pass-through rate would be 8-1/2.

THE COURT: A cap would prevent that, the kind of cap that you say was in the contract would prevent that.

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MR. BRAUN: Some of them. Correct. They prevent Doral from having to reach into its own pocket to add even more money to the interest payments that its receiving from borrowers in these original loans that it has bundled and sold to the other banks. Right.

So in his letter seeking an adjournment, Mr. Black says we have exculpatory evidence. We have found in these First Bank documents evidence of caps that prevented Doral from suffering a negative cash flow. Your Honor, our response to that is of course some of these caps existed. That's not only evident from what they received recently; it has been evident

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from the original discovery materials provided in this case.

Those caps, what they found, which we knew about, which they knew about, which the original discovery disclosed, Doral's own documents inventoried these contracts, your Honor, and described their terms, so it's not news to anybody that there were caps all the way up here. But the allegations in the indictment, in this part of the indictment, are that caps were being placed at a lower level that would actually answer the concerns of the investors and market analysts that had concerns.

THE COURT: What you are saying is the cap that was represented meant that Doral's spread wouldn't be eaten up.

MR. BRAUN: That's right. So the defendant said, for example, we will come back to this allegation, the indictment contains a paragraph that summarizes and quotes from an email the defendant sent saying that the caps are about to kick in and therefore Doral's spread, the yellow, will always be hefty and positive; as a result of the caps in the contracts, we will always maintain a hefty and positive spread. Not our spread can't get any worse than zero, it can go to zero, investor, but it can't get any worse than that, it can't go negative. That's not what he said.

He said as a result of these caps, the yellow, Doral's spread, will remain hefty and positive, not it can go to zero, but it can't get any worse. We know about those caps that say

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it can't get any worse than zero. But that's not what he told to the investing public. He didn't say it can't get worse than zero. He said it's going to remain hefty and positive as a result of these caps in our contracts. They don't exist to our knowledge nor do they exist as far as anybody else we talked to knows nor do they exist according to the documents.

THE COURT: Where is the allegation about that representation.

MR. BRAUN: The one I had in mind and I only used it as an example because it's one that the defense discusses in one of their letters to your Honor, it's in paragraph 55 of the indictment. There are other similar allegations but that's the one I just tried to summarize for you. It's page number 25.

THE COURT: Paragraph 55.

MR. BRAUN: That's the one I had in mind, your Honor.

THE COURT: I see paragraph 55. Go ahead.

MR. BRAUN: There are some similar representations described and quoted in the indictment. That's the one I had in mind when I was trying to explain what the nature of the

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20 case was and what this type of allegation is categorically,
 21 right.

22 So, they are saying we have Brady, these new materials
 23 we have just gotten, they are very important, they show that
 24 there were caps in place that prevented Doral's spread from
 25 going negative. Our response to that is that's not what the
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1 indictment says. That's not what this investor was asking
 2 about. It's not what Mr. Levis was telling him.

3 He is not saying there is a cap up here that protects
 4 us from going negative. He is saying there is a cap down here
 5 that makes sure our spread, the yellow part of this, will
 6 remain hefty and positive. He makes similar misrepresentations
 7 we allege to other folks.

8 That takes place on February 15, your Honor, 2005,
 9 which is about a month after Doral tells the world and the
 10 world becomes alarmed about it, you know what, the value of our
 11 interest-only strips is almost \$100 million less than we said
 12 it was. So the context for this is people are worried that
 13 it's going to happen again.

14 And a cap up here, that's important, because a cap up
 15 here doesn't prevent it from happening again. A cap up here
 16 let's this continue getting smaller and smaller and smaller
 17 until it goes to zero which means another impairment is quite
 18 possible especially if interest rates continue to go up.

19 THE COURT: OK.

20 MR. BRAUN: That's one category of misrepresentation.
 21 We allege it's a material one for purposes of the securities
 22 fraud alleged. The other category of representation that we
 23 say was false and material and that is related to this one and
 24 had the same overall purpose and effect of providing false
 25 assurances regarding the IOSS that Doral had on its books was

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1 they told people in the investing public through their public
 2 filings, and defendant made these statements as well in his
 3 dealings with investors.

4 Your Honor, Doral's main point of contact with
 5 investors and potential investors and market analysts was the
 6 defendant. That was part of his job as the treasurer of Doral
 7 and as one of their executive officials. He was the guy that
 8 dealt with investors and he was also the guy that dealt with
 9 these counterparty banks that were purchasing loan pools.

10 The other category of lies is that they told the
 11 investing public that in order to determine the value of its
 12 collection of interest-only strips, its portfolio of
 13 interest-only strips, Doral ran its own model.

14 THE COURT: Ran it's own what.

15 MR. BRAUN: Its own model internally, we have our own
 16 method of doing this that we run internally. Our own people
 17 determine the projected income that we are going to get over
 18 the outstanding terms of all these loans in the pools and we
 19 are going to figure out as best we can how long these loans are
 20 going to be out there, how much money is going to come to us
 21 over the course of these loans from these sales transactions
 22 that we have entered into.

23 We are going to figure out how much all of that is
 24 going to be worth. We are going to discount it to present

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25 value and we are going to put that on our books as our gain on
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1 sale, our profit from the sale of these loans. We do that
2 internally. We figure out a number for that.
3 But we don't just rely upon our own number. We also
4 obtain independent valuations from two sources. What we do is
5 we compare our number that we determine in-house with the
6 numbers we get from our independent valuations and we pick the
7 lowest of the three, right, because we are being safe and
8 conservative about this and we are going to pick the lowest of
9 the three values.

10 One of these independent valuations is based on what
11 Doral describes as market quotes meaning whoever it's going to
12 for the valuation is figuring out as best he or she can what
13 similar assets are going for in the marketplace and what buyers
14 might be willing to pay for them.

15 If Doral was going to actually sell an interest-only
16 strip out in the marketplace, it's possible, what would they
17 get, what are prospective buyers saying they would pay for this
18 asset. That's one source of independent valuation. That's the
19 one that comes along first in time. The indictment alleges,
20 your Honor, that that independent valuation, the one based on
21 the market quotes, was not a valuation at all.

22 The person who was providing Doral with that
23 independent valuation is somebody who was getting a series of
24 numbers from the defendant, copying them down in his own
25 handwriting on spreadsheets that the defendant provided him,
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1 signing his name, and sending them back. He wasn't calling a
2 trading desk. He wasn't calling anybody other than the
3 defendant who we have alleged knew what he was doing because he
4 was doing it on the defendant's instructions.

5 No doubt that will be denied at trial. No doubt we
6 will hear something about this guy lying to the defendant as
7 well. The indictment alleges that the defendant knew well that
8 the person providing the market quote independent valuation was
9 doing nothing other than copying numbers he got from the
10 defendant on instructions from the defendant and sending them
11 back to Doral. So that was a fabrication according to the
12 indictment.

13 The second independent valuation was also the
14 indictment alleges not independent. It was one that the
15 defendant arranged for in his dealings with folks at an
16 investment banking group within another Puerto Rican bank,
17 Popular Securities which is part of Banco Popular. There is a
18 group of investment bankers at Popular Securities which is a
19 small group within a larger financial institution.

20 The defendant is providing them with information about
21 all of these loan pools that he has sold to other banks and he
22 is telling the world it's up to them, they are independent,
23 they are going to decide what it's worth, we are going to
24 decide on our own what it's worth. And again we are talking
25 the lowest of these three values. One is Doral's in-house

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number. The other the indictment alleges is simply a fabrication. Then we have this investment bank.

The investment bank, the indictment alleges, and I am not going to get into particulars, I am trying to give you the gist, it's not independent the indictment alleges because it is taking directions and information from the defendant that changes and controls its whole approach to the valuation.

To give you an example that's in the indictment, your Honor, they decide in the fall of 2003, when Doral is doing this in-house, your Honor, they have to figure out how much this is all worth over the projected term of these outstanding loans. In order to do that, of course, in a floating rate IOS, they have to make some assumption about what interest rates are going to do because interest rates determine how much of the interest they are going to keep and how much has to be passed through to the purchaser of the pool.

Their assumption in-house is we are just going to assume that interest rates are going to remain the same. We are going to look at interest rates where they are during this quarter. Let's say interest rates are wherever they are; they are here or they are here. Whatever that pass-through rate is in the quarter, we are going to assume that stays where it is over the projected lifespan of these loans.

There was another way to do it, your Honor, and the investment bank providing the independent valuation to the

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defendant, to Doral, and he was the one dealing with them primarily, they decided they wanted to use a different method. They wanted to take into account something called a forward curve which is a publicly available market prediction about where interest rates are going to go.

So they are not going to assume any longer that interests rates are going to stay where they are. They are going to go to a public source of financial forecasting information, Bloomberg, and they are going to pull off something called a forward curve, there is a number of them they could use, and they are going to incorporate that into their model.

First the defendant's father then the defendant said that's not necessary because we've got caps, right, so, we've got caps. First they say they are at 3.4 percent then they say they are 3.375 percent. Anyway, your Honor, they say never mind the forward curve, that's not going to matter, because even though everybody is expecting interest rates to go up, that's not going to hurt us. You don't need to take that into account in your valuation.

Because the people at Popular Securities don't think they are independent, they actually just think they are doing something that's helping Doral internally. They think they are the internal model. They don't think they are the external independent model. They think they are just running numbers

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for Doral. They don't know they are supposed to be exercising their independent judgment. If they were exercising their independent judgment, they would be doing something very different than Doral was telling them to do and specifically what the defendant was telling them to do.

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6 There were a number of other instances, your Honor, in
 7 which we can show they were simply taking direction from the
 8 defendant rather than providing a truly independent valuation
 9 of the interest-only strips. That's the second category of
 10 misrepresentation alleged in the indictment.

11 1, the misrepresentations about the caps, 2, the
 12 misrepresentations about the independent valuations, and they
 13 overlap, your Honor because the defendant and his father tell
 14 the second source of purportedly independent valuation that
 15 they've got caps and they should assume that there is such a
 16 cap in place in valuing this asset.

17 Your Honor, overall, these two kinds of
 18 misrepresentation that the government is alleging are similar
 19 in that they provide an overall sense of assurance to the
 20 investing public that they can count on Doral with respect to
 21 its valuation of interest-only strips and they don't need to be
 22 worried about the erosion of that value in a time period in
 23 which interest rates were rising after January 05 in a time
 24 period in which Doral had already stated that the overall value
 25 of this asset was worth a good deal less than they had been

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1 saying in the recent past. So that's the basic nature of the
 2 government's case.

3 What I want to make sure the court understands, and
 4 it's important for purposes of trial and it's important for
 5 purposes of the defendant's request to adjourn the trial, is
 6 what the government's case is not about. What Mr. Black said
 7 on the phone last week, and you see this to some extent in his
 8 letters as well, is that their defense is that Doral was
 9 valuing this asset in a reasonable manner. So apparently he
 10 wants to consult with his experts and perhaps call them,
 11 although we have received no experts notice, and have people
 12 testify that what Doral was doing internally was OK and that
 13 the assumptions it was using were defensible and the number it
 14 was putting on this asset, whether it was 700, 800, \$900
 15 million, we can defend that number.

16 Your Honor, that's beside the point from the
 17 government's perspective. The government's case is about the
 18 defendant deceiving people about the caps and the independent
 19 valuations. This is not a kind of traditional accounting fraud
 20 case which is perhaps what the defense has in mind in which the
 21 government is alleging that a corporation has simply cooked its
 22 books and is telling the world we have something that it
 23 actually doesn't have or we have something worth X when
 24 actually that thing is worth half of X.

25 That's not this case; it doesn't fit into that model.

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1 THE COURT: What happened to these interest-only
 2 strips.

3 MR. BRAUN: In 2005, after the events alleged in the
 4 indictment, the indictment does explain this well, in the
 5 spring of 2005, after Doral has some people in because the
 6 Federal Reserve has concerns about what's going on at Doral,
 7 Doral hired these consultants in the fall of 2004. Over the
 8 course of time from 2004 into the spring of 2005, more and more
 9 information comes to light inside Doral about how it's been
 10 evaluating these IOSSs.

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11 Doral itself with its accountants and with these
 12 consultants, decides in the spring of 05 that the IOSS, we're
 13 going to change our method for determining their value and we
 14 are going to say that they are worth hundreds of millions of
 15 dollars less than we had been saying before. Before we said
 16 they were worth 8, \$900 million. Now we are going to say they
 17 are worth maybe 3, \$400 million. I don't have the exact
 18 numbers handy, but they are taking hundreds of millions of
 19 dollars off the declared value of this asset.

20 Again, this is important from the government's
 21 perspective, the fight that we have here, the case that we
 22 intend to try is not, ladies and gentlemen of the jury, they
 23 said this asset was worth 9, it was only worth 3. I was
 24 answering your Honor's question about what happened; that's
 25 what happened.

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1 Over the course of time in 2005, starting in January
 2 then continuing through March and April, the defendant was
 3 making various statements to the investing public that didn't
 4 make sense to the people and the value of the stock was just
 5 declining, declining, and declining. Then finally in the
 6 spring, the April-May time period, is when they come around to
 7 changing definitively their method for doing this. That's when
 8 they knock hundreds of millions of dollars off the value of
 9 this asset.

10 Again, we are not going to say to this jury, ladies
 11 and gentlemen, in truth, this asset was worth 3 and they told
 12 everybody it was worth 12. It's not that kind of case. What
 13 we are going to say to the jury is they lied to everybody about
 14 protections that they had in place. They lied to everybody to
 15 give them a false sense of security that they can count on what
 16 Doral was doing; we had independent valuations checking us,
 17 right, we had caps in place that protected us from further
 18 erosion of our spread. That's what we are going to tell the
 19 jury.

20 We are not going to tell the jury the defendant lied
 21 by saying that this asset, again this is all a prediction of
 22 what the thing is worth, your Honor. They have to look in the
 23 future and make a bunch of assumptions and predictions about
 24 what's going to happen. So it's a difficult asset to put a
 25 number on. We all recognize that. It's in part for that

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1 reason that we can't say definitively this thing is actually
 2 worth 3 and the defendant told everybody it's worth 10 even
 3 though ultimately that's what Doral decided to do.

4 The defendant no doubt would like to say Doral didn't
 5 have to do that; they did that because they were pressured to
 6 do it, they felt they had no choice, and actually it was
 7 reasonable and defensible for them to tell the world it was
 8 worth what they were saying previously. That's not the case we
 9 are going to try. We don't think that's the case alleged in
 10 the indictment.

11 That's another reason why we fail to understand the
 12 defendant's argument as to why these documents they just
 13 received are so critical. This comes up specifically with
 14 respect to R&G documents. I will come back to the First Bank
 15 documents in a moment. What they say about R&G, one of the

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16 banks that purchased their loans, later than Doral and to a
 17 somewhat more limited extent, R&G started doing what Doral was
 18 doing. They started generating interest-only strips and
 19 selling their own mortgage loans.

20 The defense says in the context of their adjournment
 21 request, these R&G documents are highly significant because
 22 they show R&G was using an assumption to put a number on its
 23 interest-only strips that was similar to the method that Doral
 24 was using in a way. One of the critical assumptions that R&G
 25 was using was the same one that Doral was using which shows

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1 that in their view that what Doral was doing internally was
 2 justifiable. They are not the only ones doing it; there is
 3 another bank doing it.

4 Again, we are not here to quarrel about whether or
 5 not what Doral was doing internally was unprecedented. We
 6 could try a bunch of collateral issues as to what other banks
 7 were doing with their assets. Perhaps R&G was doing it similar
 8 to the way Doral was doing it. Perhaps the government can go
 9 find 20 banks that were doing it differently. We can get a
 10 bunch of accountants and a bunch of experts in here and they
 11 can all dispute what the best way is.

12 That's not the case we are going to try.

13 THE COURT: I had better hear from the other side.

14 MR. BRAUN: Time permitting, your Honor, I would like
 15 to explain the government's view as to why the documents that
 16 we produced to them recently are not as important as they say
 17 they are.

18 THE COURT: You have indicated that.

19 MR. BRAUN: Thank you for the opportunity, judge; we
 20 do appreciate your time, your attention.

21 MR. BLACK: May it please the court, I must admit we
 22 do have a fundamentally different view of this case and the
 23 indictment than the government does. Just to give a little
 24 preface to the court, Mr. Levis was the treasurer of Doral
 25 Financial Corporation, located in San Juan, Puerto Rico.

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1 Doral was the number 2 bank in Puerto Rico at the
 2 time. They sold mortgages; they put them together in pools and
 3 they sold them mainly to First Bank, which is one set of
 4 discovery documents we are talking about, and they sold similar
 5 kinds of instruments that R&G Financial sold and that's why we
 6 are interested in those documents.

7 As the government said, I am not going to quarrel with
 8 their definition of the IOS, but to tell the court, over four
 9 years they sold 166 pools of these loans. What would happen is
 10 there would be an original document saying we will sell you X
 11 number of loans then over a substantial period of time they
 12 would fund that pool and they would have separate documents for
 13 all of that. To advise the court there are caps; there are
 14 caps all over the place at different amounts.

15 But what happened with these pools, because they are
 16 pools, everything is averaged. It's not like you have to worry
 17 about one cap being at 9, one at being 6, one being at 3. All
 18 the pools were averaged so they would have weighted averages of
 19 everything dealing with maturities, dealing with interest
 20 rates. There are all kinds of weighted averages. That's what

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21 makes this very complicated, because we have 166 of these
 22 pools, things were treated as weighted averages, and there is a
 23 huge amount of figures involved in working this out.

24 The government told the court on the phone last week
 25 and they tell the court today, they are not accusing Mr. Levis

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1 of making a fraudulent statement about the worth of this asset.
 2 When Doral would sell its pool of mortgages, it would sell it,
 3 let's take First Bank, let's say it sold \$100 million worth of
 4 these mortgages to First Bank, First Bank would give Doral \$100
 5 million. So it would be sold at par. Nobody makes a dime yet.

6 The agreement then is the principal and part of the
 7 interest goes to First Bank and the other part of the interest
 8 goes to Doral. Doral's obligation was to put that asset on its
 9 books and value it at some amount. What we are first of all
 10 saying is that the government today says that value they put on
 11 the books, we are not going to argue is fraudulent; we are
 12 going to argue that Mr. Levis lied about caps and while
 13 interest rates would affect the assets, but there is no fraud
 14 with the original valuation on the sale of these mortgages.

15 We believe that the indictment says otherwise. I am
 16 going to hand up to the court what we have marked as Exhibit 1.
 17 This exhibit has first of all the statements of Mr. Braun that
 18 he made on the phone which we don't really have to go into
 19 because he made the same statements today. But the second page
 20 is paragraph 60 of the indictment in which it accuses the
 21 defendant of overstating by approximately \$500 million the
 22 worth of these IOSSs and that he overstated the net income of
 23 Doral in excess of \$600 million.

24 Far from not charging this in the indictment, that is
 25 the main charge in the indictment. In the indictment in

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1 paragraph 9, it accuses Mr. Levis of materially inflating the
 2 value of its IOSSs and the earnings associated with it. That
 3 was page 3. On page 4, paragraph 42 of the indictment, it says
 4 at the bottom of the paragraph --

5 THE COURT: What was it, paragraph 9.

6 MR. BLACK: Paragraph 9 is the one in the last
 7 sentence it says the value of the IO and the earnings
 8 associated with it were materially inflated. That is the
 9 original value put on the books by the internal method used by
 10 Doral that the government now says is not fraudulent.

11 In paragraph 42 of the indictment, the grand jury
 12 charged and the last four lines --

13 THE COURT: I am still at paragraph 9; paragraph 9 is
 14 a long paragraph.

15 MR. BLACK: That's why I retyped it. It says they
 16 materially inflated the value of its IOS. That is what the
 17 grand jury alleges on paragraph 9.

18 THE COURT: But it says, you excerpt, these outside
 19 valuations were used and so forth. That's what Mr. Braun was
 20 talking about, the outside valuations.

21 MR. BLACK: What Mr. Braun has done is saying we are
 22 only charging the outside valuations, but the indictment does
 23 not say that. It says that the outside valuations were used to
 24 cover up the fact that the internal valuation was materially
 25 inflated, and as paragraph 60 said, it's inflated by an amount

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of \$500 million.

THE COURT: Just a minute.

(Pause)

MR. BLACK: Back to paragraph 60, the second page of our exhibit, that is where it says the asset was overstated by approximately \$500 million. In paragraph 42 of the indictment which is attached there, it says at the bottom, the last four lines, because Doral was using a fixed rate assumption rather than the forward curve to value its IO portfolio, the value at which Doral was carrying its IO portfolio on its books was overstated by an excess of \$450 million.

So clearly the indictment alleges over and over again, and there is a couple more I attached, I think it's to the same amount, it keeps saying that the original asset was materially inflated. To show the court how the government has changed its theory of the case --

THE COURT: Can I just say this. What I am looking at is a very, very lengthy indictment, full a lot of material. The indictment will never go to the jury. And it has happened before and it will happen again that the government does not seek to prove everything in the indictment and the government does not have to.

If we were at the trial and the government were past the opening statement, if the government were putting on its case, and the government put on a case based on part of the

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indictment and if that case included the elements of a violation of the relevant antifraud securities statute, that would be a sufficient case to go to the jury. If it came time for the defense to put on a case, I don't think any judge would allow the defense to start talking about things that were not in the government's case simply because they happened to be in the indictment.

This is a huge piece of writing, this indictment. So maybe what we are really coming to grips with is what is the government's case going to be. It seems to me obviously they can't go beyond the indictment. There are a lot of things they cannot do because the indictment is controlling. But it seems me, I could be wrong, but it seems to me that so long as they put on a case in which certain allegations of the indictment are proven, if that case proves a crime, they have a case, do they not.

MR. BLACK: Yes, your Honor, but in this particular --

THE COURT: The answer is yes. Isn't that where we are coming out here. The government has stood up in court and said what its case is.

MR. BRAUN, is this your case, what you told me.

MR. BRAUN: It is, your Honor.

THE COURT: Now it seems to me Mr. Black is pointing out things in the indictment that go beyond what you have said this afternoon. What about those things.

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MR. BRAUN: Thank you, judge. In one or two
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instances, he has pointed out one or two things in a lengthy charging instrument that suggest something beyond what I said, particularly paragraph 60. Before we walked in here today, I went through the indictment and found everything I could that could conceivably characterize our case in the way that the defense has. We have told them in the past that's not our case and these conversations again have led me to go through this document and find everything I could that could be taken out of context to say this is the government's case.

THE COURT: Mr. Black is not taking anything out of context. He has a right to come in and refer to the indictment. It's the government's indictment; this is the animal that you produced.

MR. BRAUN: Indeed he does, your Honor. When he talks about paragraph 42 and he says the government is alleging there was an overvaluation of the asset, but if you read the whole paragraph it says not that there was, it says a consulting firm came in in 04 and they decided that it was.

The allegation in 60, which is the one that is the one that troubles the government the most, I will be candid about that, your Honor that's the one that out of everything in the indictment, that's the one that allows them to grab on to this and say the government has changed its theory which my predecessors have assured me we have not done.

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It's just drafted a bit imprecisely, I will acknowledge that, and we are thinking very seriously of going back to the grand jury precisely to get rid of that allegation. It's under a heading that says Doral denounces the devaluation of the IOSS. Really what the government should have said there if it said anything along those lines, I think we said too much here, was this is what Doral decided, your Honor.

The government in this part of the indictment is telling the story of what happened and what Doral decided to do in the spring of 05 as alleged here is to devalue the IOS portfolio by this margin. That is what Doral did.

THE COURT: Look here.

MR. BRAUN: That's not our case.

THE COURT: I have an appointment uptown to judge a moot court. What I want to say is this. I have not read the indictment, but I begin to see that it is a very lengthy document; it is overly lengthy. I don't know what the rules are about indictments, but the rules about complaints in civil actions, there is a rule, short and plain statements. Nobody even bothers with it. You get a complaint in a civil action to read like Encyclopedia Britannica. They are enormous things. People have given up trying to enforce that pleading rule.

I don't know what the pleading rules are for indictments I, have no idea, but I think this is an overly big animal. I used that word twice.

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But you can hardly blame Mr. Black and his colleagues for taking the indictment seriously and thinking that the government meant what it said when it procured this indictment and you may have caused Mr. Levis to incur some extra legal expense in having lawyers answer the allegations you never really meant to prove, which is unfortunate.

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7 But we are at the stage where it seems to me the
8 government has a right, obviously within certain rules of law,
9 to define the government's case and that's the case that will
10 be tried. Under no circumstances am I going to make the
11 time of trial something that is unfair to the defense. If the
12 defense needs more time, the defense will get it. But right
13 now, I think as far as the issues we are trying to address
14 today, I think the scales are tipping in favor of the
15 government, simply because it's the government's case, and the
16 defense does not have any reason to defend another case.

17 But there has to be a definition of the government's
18 case, and I don't know enough to say whether you have to go
19 back to the grand jury, but it seems to me that in some form,
20 that you have to make the record very, very clear as to the
21 limitations that the government is establishing as to what it
22 will prove in its case. Then it's a matter of seeing whether
23 that constitutes a case.

24 Our present trial date is what.

25 MR. BRAUN: March 22, we are scheduled to start

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picking a jury.

1 THE COURT: I don't know the history of all the
2 communications between the government lawyers and the defense
3 lawyers, I don't know that, but it seems to me that right now,
4 unless there is something that I really don't appreciate and
5 know about, it seems to me that the indictment has been too
6 expansive and maybe has led to some uncertainty on the part of
7 the defense as to what the government's case really is. Maybe
8 it was all made clear long ago; I don't really know.

9 What I would like to do and I will say this. If I
10 believe that as of this day, the scope of the government's case
11 was not clear, I will grant an adjournment simply for that
12 reason. If I am apprised very quickly that the scope of the
13 government's case was made clear at an earlier stage, I will
14 hesitate to prolong the time before trial.

15 I can't really have any more of this hearing tonight
16 or this afternoon. But the government has got to give me some
17 kind of letter and I mean by the end of the day tomorrow what
18 is your position as to when, if it was some time before today,
19 you may made clear the scope of the government's case. The
20 other side can respond right away too. Then I will of course
21 by the end of the week decide whether we are going to adjourn
22 the trial because everybody has to know.

23 That's all we can do this afternoon. Thank you.

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